BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

Case No. ER-83-42

In the matter of The Empire District Electric Company of Joplin, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.

APPEARANCES: James C. Swearengen, Attorney at Law, W. R. England, III, Attorney at Law, and Gary W. Duffy, Attorney at Law, Post Office Box 456, Jefferson City, Missouri 65102, for The Empire District Electric Company.

Robert C. Johnson, Attorney at Law, 314 North Broadway, Suite 950, St. Louis, Missouri 63102, for Union Carbide Corporation.

W. H. Bates, Attorney at Law, and Stuart W. Conrad, Attorney at Law, 2600 Mutual Benefit Life Building, 2345 Grand Avenue, Kansas City, Missouri 64108, for Atlas Powder Company, FAG Bearings Corporation, Farmers Chemical Company and Missouri Steel Castings Company.

Michael C. Pendergast, Assistant Public Counsel, Office of Public Counsel, 1014 Northeast Drive, Jefferson City, Missouri 65101, for the Office of Public Counsel and the public.

Eric Kendall Banks and Edward J. Cadieux, Assistants General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REPORT AND ORDER

Introduction

On July 30, 1982, The Empire District Electric Company of Joplin, Missouri (hereinafter, Company or Empire) filed with the Missouri Public Service Commission (hereinafter, Commission) revised tariffs reflecting increased rates for electric service provided to customers in the Missouri service area of the Company. The revised tariffs bore a requested effective date of August 30, 1982, and are designed to increase the Company's jurisdictional gross annual revenues by approximately $7,400,000, or approximately 9 percent, exclusive of gross receipts, franchise and other local taxes.

On August 20, 1982, the Commission suspended the revised rate schedules from August 30, 1982, to June 28, 1983, unless otherwise ordered by the Commission. That order established a schedule of proceedings for the time of filing the Company's evidence, the date by which applications to intervene were to be filed, the date by which Staff and all other parties were to file evidence and, finally, dates for prehearing conference and hearing. By subsequent orders at the request of various parties, the schedule of proceedings was modified.

By its order of November 30, 1982, the Commission granted the applications to intervene filed by Atlas Powder Company, FAG Bearings Corporation, Farmers Chemical Company and Missouri Steel Castings Company (collectively referred to as the Atlas Industrials) and also granted the application to intervene of the Union Carbide Corporation (hereinafter, Union).

To permit the Company's customers an opportunity to testify concerning the proposed increases, the Commission set a local public hearing which was held on February 14, 1983, in Joplin, Missouri.

On February 28, 1983, the parties began the prehearing conference in this matter, from which a hearing memorandum was subsequently produced which set out those issues to be litigated at the hearing in this matter and those areas of agreement between the parties. On March 21, 1983, the hearing was duly convened and the record produced upon which this report and order is based. At the outset of the hearing the Office of Public Counsel made two motions to exclude consideration of certain matters relating to the issues on rate of return and deferred taxes. Those motions will be discussed with the issues themselves in the findings of fact. All parties have been afforded an opportunity to file briefs and reply briefs, and those documents have been considered in the deliberations in this matter.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact.

The Company

The Empire District Electric Company is an electric corporation as defined in Chapters 386 and 393 under the Revised Statutes of the State of Missouri 1978, with its administrative offices and principal place of business located in Joplin, Missouri. Empire is engaged in the generation, transmission and distribution and sale of electric energy in the states of Missouri and Kansas.

Elements of Cost of Service

The Company's authorized rates are generally based on its cost of service or its revenue requirement. As elements of its revenue requirement, the Company is authorized to recover all of its reasonable and necessary operating expenses and, in addition, a reasonable rate of return on the value of its property used in public service. It is necessary, therefore, to establish the value of the Company's property and to establish a reasonable return to be applied to the value of its property or rate base which, when added to the allowable operating expenses, results in the total revenue requirement of the Company. By calculating the Company's reasonable level of earnings, it is possible to mathematically calculate the existence and extent of any deficiency between the present earnings and any additional revenue requirement to be allowed in any rate proceeding.

Test Year

The purpose of using a test year is to create or construct a reasonably expected level of revenue, expense and investment during the future period in which the rates to be determined herein will be in effect. All of the aspects of the test year operations may be adjusted upward or downward to exclude unusual or unreasonable items or to include unusual items, by amortization or otherwise, in order to arrive at a proper allowable level of all of the elements of the Company's operations.

For purposes of this proceeding, Staff and Empire utilized as a test year the 12-month period ending October 31, 1982, updated through December 31, 1982, for rate base items and also updated for certain known and measurable changes.

Transmission Allocations

The Staff and Company disagree on the amount of transmission plant and expense that should be allocated to Missouri jurisdictional ratepayers. Generally, transmission plant and expense are allocated between Missouri customers in relation to their usage and that of other jurisdictions, such as the Company's Kansas customers. In this particular instance Empire has entered into contracts with the City of Higginsville (Higginsville), the Kansas Electric Power Cooperatives, Inc. (KEPCO), and the Board of Public Utilities of Kansas City, Kansas (BPU). The contracts are designed to effect the transportation of power from the Southwest Power Administration (SPA) of the United States Department of Energy to the three entities mentioned above. The SPA is a part of the federal government responsible for the sale of power generated at federal projects. Public bodies such as Higginsville, KEPCO and BPU are to be given special preference in the sale of such power. This is accomplished by using Empire's transmission capacity.

The Company correctly points out, and the Staff does not disagree, that these contracts are not firm power contracts in the usual sense of the term when defined as power and energy that is continuously available to the buyer and guaranteed by adequate reserve capacity. Normally, Company resources committed to a buyer under a firm power contract would be allocated to that buyer and not Missouri jurisdictional ratepayers.

The contracts in question provide for transmission of power, when available, from the Southwest Power Association via Empire's transmission facilities to the transmission lines of the Kansas Gas & Electric Company and the transmission lines of the Kansas City Power & Light Company for ultimate delivery to Higginsville, KEPCO and BPU. Since Empire is required only to transmit power when available and does not guarantee the availability of the power by reserve capacity, the contracts are not firm. However, the Staff maintains the contracts are firm in nature. That is, Staff maintains that when power is available from the SPA, Empire is required to transport it, thereby depriving Missouri jurisdictional ratepayers of the benefit of certain portions of Empire's transmission capacity. If these contracts did not exist or were canceled tomorrow, the 8.13 percent of transmission capacity Staff allocated to the contracts would then be allocated to Missouri jurisdictional ratepayers.

Thus, the question herein is whether the Company can interrupt or refuse to transmit power from the SPA, when available, to Higginsville, KEPCO and BPU. Each contract provides for the interruption or curtailment of power. For example, the Higginsville contract provides that "if conditions develop such that the continued delivery of such power and energy in the sole judgment of [Empire] would impair or jeopardize [Empire's] system or commitments to others, such delivery will be discontinued until those above conditions are corrected." The KEPCO contract provided for the reduction of power transporting "at the sole discretion of Empire if its system integrity or the system economics of Empire customers are adversely affected." The BPU contract contains only an "uncontrollable force" clause. While the three contracts are not exactly the same, the Staff and the Company have tried them together as essentially similar, and therefore the Commission will consider them as such.

Based upon the foregoing, the Commission finds the contracts to be interruptible by Empire when conditions require the use of the transmission capacity in question for Empire's Missouri jurisdictional ratepayers. Consequently, the Commission finds the transmission allocation for Empire should be the Company's suggested 79.75 percent.

Missouri Net Operating Income

At the hearing the Company projected its available net operating income to be $15,432,684. Other parties to the proceeding have proposed adjustments which would establish a higher net operating income available to the Company.

Forecasted Fuel

The Staff and the Company agreed that $787,091 of the increase in revenue requirement in this case represents forecasted fuel costs which are subject to refund if the actual unit prices for coal are less than the forecasted unit prices as reflected in Appendix A to Exhibit 1, the hearing memorandum. The parties requested the Commission to establish, and the Commission so establishes by this Report and Order, a separate investigatory proceeding for the purpose of audit and verification of the forecasted fuel costs. In the event it is determined after such investigation and a hearing to be held in April 1984 that Empire is obligated to refund amounts collected pursuant hereto, simple interest on such amount shall accrue beginning on January 1, 1984, until the date of credit or refund, if any, at a rate identical to the rate of return on Empire's investment authorized by the Commission in this case.

Capitalization of Administrative and General Expenses

The Staff asserts that the Company has not properly accounted for the amount of the Company's special payroll that should be capitalized due to construction related activities. Generally, salary expenses created by employee activity related to construction are to be capitalized as part of the asset created by said activity. For example, time cards are kept for the Company's hourly employees engaged in construction, identifying the project worked on and the number of hours spent on the project. This allows a direct assignment of construction related activities for capitalization purposes. As concerns the Company's special payroll employees who are paid on a monthly basis, such as management, the parties agree that it is impractical to keep time cards identifying construction related activities and consequently a surrogate method must be used.

The Uniform System of Accounts delineates how the construction related activities of Company employees are to be accounted for. In the event that it is impractical to identify the actual time engaged in (e.g., the use of time cards), the Uniform System of Accounts requires that capitalization be taken "upon the basis of a study of the time actually engaged during a representative period." General Instruction No. 9, U.S.A. The Staff claims the Company has not conducted such a study which adequately capitalizes special payroll and expenses related to construction. No party cited any authority describing the nature of a study as referred to in General Instruction No. 9 of the Uniform System of Accounts.

The documentation of the Company's study as provided to the Staff is contained in Exhibit 5. Upon examination of those documents, the Commission agrees with the Staff that the documentation is insufficient to constitute a study and is not adequate support for the capitalization rates used by the Company. The "study" amounts to questionnaires sent to Company management employees, who then, on an individual basis, determined the percentage of time they believed they had spent on construction related activities. There were no instructions or guidelines provided to the employees indicating a method of documentation by which to calculate the amount of time spent on construction related activities. Furthermore, the absence of guidelines resulted in a lack of uniformity in employee responses to the questionnaire. For example, some employees figured construction time percentages on yearly hours of work which included vacation time, while some did not include vacation time.

Due to inadequate time and resources within the confines of a rate case, the Staff did not conduct a study of its own and developed the direct supervisory method as an alternative. The Staff asserts its method is a better approximation than the Company's method of the amount of special payroll expense that should be capitalized. The direct supervisory method compares regular payroll expense not related to construction to total regular payroll dollars to produce a percentage therefrom. The percentage indicates the proportion of annualized special payroll and related expenses which will be treated as operating expense, and the inverse of such constitutes the portion of annualized special payroll and payroll related expenses to be capitalized as related to construction.

The Company argued that the Staff's proposed method, if adopted, violates Section 393.140(4), R.S.Mo. 1978, by depriving Empire of the required six months notice of change in the method of keeping its accounts. However, the Staff is not seeking a change in the Company's accounting procedures. The Staff has made an adjustment for the Company's failure to provide a study documenting the Company's capitalization rates. Furthermore, this is an adjustment for ratemaking purposes and not a change in the Company's method of keeping its accounts. Thus, the Commission is not barred by Section 393.140 from adopting Staff's proposed method.

For ratemaking purposes the Commission finds that a study as referred to in the Uniform System of Accounts should be used. Due to the lack of time reports or documented time studies to support the capitalization rates used by the Company, the Commission is of the opinion and finds that the Company has failed to provide an adequate study and that the Staff's direct supervisory method should be used as a substitute in this instance. However, the Commission in this case is not endorsing the direct supervisory method as the most appropriate means of calculating capitalization percentages for that part of the Company's special payroll and related expenses related to construction activity. The Commission is using Staff's method in the absence of an adequate Company study. The Commission further notes that the development of an adequate study is the Company's burden and not Staff's. Consequently, The Commission directs the Company to file an appropriate study in its next rate case.

An additional issue raised by the Company relative to the Staff's adjustment in this matter in the event the Commission found in favor of Staff's methodology is whether the capitalization proposed by the Staff should be included in the Company's rate base. The Company argues that if it is denied the recovery in rates of those parts of its special payroll considered to be construction related, it should be allowed to increase its rate base by the said amount, or it will be denied the recovery of a return on the dollars invested by the Company (i.e., salary expense) during the first year these rates are in effect.

The Commission rejects outright the Company's arguments on this point. The capitalization here determined is a reduction of the amount of payroll expenses the Company will be allowed to recover in the future when the rates set herein go into effect. The capitalization adjustment is for construction related work that will occur in the future. Until that construction related work occurs, it cannot be capitalized and put into rate base.

Summary

As a result of the adjustments herein found to be reasonable and proper, the Commission finds that the Company's net operating income available for purposes of this case is in the amount of $15,467,556.

Rate Base

As a result of the Staff's investigation it is of the opinion that the Company's net original cost rate base is in the amount of $149,793,487, exclusive of the allocation issue. Company claims a rate base of $152,611,267. The difference of opinion exists with respect to the following.

Accumulated Deferred Taxes Associated With Accelerated Depreciation and Investment Tax Credit

The Company filed supplemental direct testimony to correct what it asserts was a mistake discovered after its direct testimony was filed in this matter. The supplemental testimony seeks to increase the Company's rate base by $4,091,895. The Company claims it incorrectly reduced its rate base by the amount of deferred tax expense accumulated from accelerated depreciation and investment tax credits on its books from 1954 through 1973, in that while the Company was normalizing tax timing differences on its books, it was using the flow-through method for ratemaking purposes. Consequently, the Company's rate base should not be reduced by the amount of deferred tax expense created by normalizing tax timing differences on the Company's books, if it was indeed flowing through such timing differences.

The Office of Public Counsel filed a motion to exclude consideration of the deferred taxes and investment tax credit issue as it relates to the supplemental testimony of John L. Wilson and G. C. Hunter. Public Counsel maintains that the Commission is precluded by law from granting the increased rate base and corresponding revenue deficiency, arguing that would amount to rate relief in excess of that incorporated in the Company's original tariffs. Public Counsel refers the Commission to its order issued in Case Nos. WR-83-14 and SR-83-15, Re: Missouri Cities Water Company, on February 17, 1983.

The Commission finds that Public Counsel's motion to exclude should be denied. The issue in the Missouri Cities case cited above dealt with the company requesting a specific additional rate increment over and above the tariffs initially proposed. Case law is clear that the Commission cannot grant rate relief in excess of that filed for even if a company shows a larger revenue deficiency than that contained in its proposed tariffs. The instant issue is not an attempt to enlarge the Company's proposed filing. The Company by its supplemental testimony is only attempting to show additional evidence of a revenue deficiency. As the Commission pointed out in a similar situation in its report and order in Case No. ER-82-39 at page 47, Re: Missouri Public Service Company, this issue ". . . is simply one of numerous issues concerning the components of the Company's cost of service, the resolution of which result in the determination of the Company's revenue requirement which the Company should then be authorized to collect from ratepayers through its rates, subject to the limitation, of course, that the Commission cannot allow rates which are greater than those contained in the Company's proposed tariffs."

The Staff treated the contested deferred taxes and investment tax credit as a reduction from rate base, in keeping with the Company's practice prior to the filing of its supplemental testimony in this case. The Staff pointed out that this issue, by its nature, requires interpretation and evaluation of events which occurred as long as 30 years ago. Where no report and order determining a company's elements of cost of service exists, this Commission cannot reach back in time and determine the intent of previous Commission actions that allowed rate decreases to go into effect without investigation or suspension. Thus, the real question of whether Empire was flowing through tax timing differences for ratemaking purposes is impossible to determine. Furthermore, the Company witness admitted that question could not be answered by looking at the Company's books. If this question cannot be answered from the Company's books and there are no reports and orders to look to, the Commission must agree with the Staff that this is a very "cold trail" and the Commission therefore adopts the Staff's position. Furthermore, Empire never previously raised a question regarding the propriety of the rate base reduction of accumulated deferred taxes and investment tax credit involved herein. The apparent reason for this was Empire's belief ". . . that its Missouri rates had always been based upon such tax normalization." The Commission in this instance is greatly persuaded by the Company's prior practice.

As concerns the admissibility of the Duff & Phelps reports, the Commission hereby grants Staff's motion to strike. While it might appear that witness Wilson used the Duff & Phelps reports to reach his opinion, no proper foundation was laid to do so. The reports were presented on rebuttal after his opinion and evidence in support thereof was previously presented. Furthermore, the reports as referred to in Exhibit 31 were offered as direct corroborating evidence independent of witness Wilson's opinion.

Summary

As a result of the foregoing adjustments and adjustments elsewhere in this order, the Commission finds the net original cost rate base to be $151,963,087.

Rate of Return

The Company recommends that it be granted a return on common equity of 16.5 percent. The Staff recommends a range of return on common equity of 14.03 to 15.05 percent, with a 14.54 percent midpoint. The Office of Public Counsel asserts the Commission can grant no more than a 14.78 percent return on common equity.

The Office of Public Counsel filed a motion to exclude consideration of rate of return recommendations in excess of those supported by Empire's initial tariff filing. Public Counsel makes the same argument in this motion as it did in its motion to exclude Company's evidence on the issue of deferred taxes. That is, the Commission is precluded from granting rate relief in excess of that requested in the Company's tariff filing as supported by the Company's direct testimony. By Public Counsel's interpretation, the Company is not allowed to request or prove a greater revenue deficiency on any single issue or element of cost of service greater than that issue's contribution to the overall revenue deficiency filed for and supported by its direct case. In this rate case, if all of the Company's direct testimony concerning the Company's cost of service were accepted as the Commission's findings in this case, the Company could be granted a return on common equity of no more than 14.78 percent, for to allow more would result in a greater revenue increase than filed for, i.e., something in excess of $7.4 million. The Commission's position has been and will remain that a party may present evidence on any issue tending to prove any amount of revenue deficiency. Consequently, subject to the limitations of the rules of evidence and the Commission's own orders, a party may present evidence on any issue to substantiate a revenue deficiency, even one in excess of that which was filed in the Company's tariffs. Therefore, the Commission denies Public Counsel's motion.

Public Counsel did not take a position other than that set out in its motion. Both the Company and Staff used discounted cash flow (DCF) analysis to arrive at their recommended rates of return. A DCF analysis, which the Commission has consistently found to be an appropriate methodology for determining return on equity, is based upon the assumption that current investors value a share of stock by projecting the future flow of dividends and future value of the share of stock, discounting those values to the present time. The basic formula for DCF analysis is expressed as an equation:

$$k = \frac{d}{p} + g$$

In the equation, "k" equals the required rate of return on common equity, "d" equals indicated dividends per share, "p" equals price of the stock, and "g" equals an expected growth factor. This equation also must be adjusted for certain costs associated with the issuance of new stock referred to as flotation costs.

The evidence presents an array of yields, growth rates and flotation costs to arrive at the Company and Staff's recommended returns on equity. At the time the briefs were submitted, the areas of disagreement were only between the Company and Staff's suggested growth rate ranges and suggested flotation costs. The Staff's range for the yield component of the DCF analysis, 10.5 percent to 11.0 percent, was adopted by the Company.

In determining its growth rate range the Staff evaluated both dividends per share and earnings per share data. The Staff used ten-year growth rates beginning with 1971 and ending with 1982 computed on both a trended line method and by a compound interest method. This data, which covers some 20 years, was used in conjunction with the earnings per share data to develop Staff's recommended growth rate range of 3.0 to 3.5 percent. The Company argues this method places too much emphasis on historical data which includes years of unusual economic conditions, such as periods of double digit inflation and an all-time high in the prime lending rate. The Company points out that during those years Empire was restricted from increasing dividends regularly, and therefore historical based growth rates are too low. Because it appears that the future will be characterized by an improving economy with moderate inflation and interest rates, the Company suggests a growth range of 4.0 to 6.0 percent.

The Company supports this growth range with several factors. Empire found most electric utilities averaged a growth rate range of 4.0 to 6.0 percent during the years 1971 through 1982. While the Company noted Merrill Lynch's recorded average growth rate for electric utilities for the last five years was 5.0 percent, it did not correlate this data to Empire itself. For the ten-year period ending in 1971, a relatively stable economic period, Empire's growth rate computed on a compound basis was 6.04 percent. In 1982, Empire increased its annual dividend by 5.6 percent. While the Commission finds some merit in the Company's criticism of Staff's growth rate range, the Commission finds the Company's evidence insufficient to support a range in excess of Staff's.

On the subject of flotation costs, the Staff used a 5.0 percent adjustment whereas the Company used 5.95 percent. Flotation costs are the costs associated with the sale of new issues of common stock, and to account for such in determining a rate of return on common stock an adjustment must be made. The Staff based its flotation adjustment on the basis of the Company's last two stock issuances, which coincidentally happened to be the largest two of the Company's last four offerings. The Company objected to this, arguing that it is unlikely any future offering will be of such a magnitude. The Company used an average of its last four issuances. In considering the arguments made on this issue, the Commission finds that it is more equitable to use an average of the Company's last four issuances of stock, which represents varying issuance costs, rather than the two least-cost instances based upon the largest offerings of stock.

The range which results from the application of the above findings, i.e., Staff's yield, Staff's growth range, and Company's computation of flotation costs, is

14.12 percent to 15.15 percent. The Commission notes the midpoint of this range is 14.63 percent, and finding no sufficient reason to adjust within the range with respect to required rate of return on equity, finds it as reasonable in this case.

Part of the evidence in this issue presented by the Company on rebuttal was objected to by the Staff as a presentation of direct evidence on rebuttal which under the terms of the Commission's suspension order and schedule of proceedings in this case is improper. That evidence concerned management efficiency. The Staff's objection and motion to strike part of Exhibit 28 are well taken as concerns the issue of required return on equity. Therefore, the Commission has not considered that information in determining this Company's required rate of return on equity. However, the Commission believes the evidence of management efficiency to be of vital importance to the next issue, rate of return adjustment. Therefore, the Commission accepts into evidence the entirety of Exhibit 28, but only for the purpose of determining the propriety of a rate of return adjustment. The Commission has pointed out in past orders the importance of such evidence to the determination of a rate of return adjustment, and expects this type of evidence in the future.

Rate of Return Adjustment

The Commission has noted in past cases the propriety of adjusting a company's rate of return to account for management efficiency, or the lack thereof. In the Commission's report and order issued in ER-82-39 and WR-82-50, Re: Missouri Public Service Company, the Commission addressed that issue directly and made a downward adjustment therein for poor company performance. Authority to make adjustments is clearly authorized by law. E.g., Bluefield Water Works & Improv. Company v. Public Service Commission, 262 U.S. 679, 693, 43 S. Ct. 675, 679, 67 L.Ed. 1177, 1183 (1923); Smyth v. Ames, 169 U.S. 466, 547, 18 S. Ct. 418, 42 L.Ed. 819 (1897); D. C. Transit System v. Washington Metro. Area Transit Commission, 466 F.2d 394, 407-13, 418-23 (D.C. Cir. 1972). New Jersey v. New Jersey Bell Tel. Company, 30 N.J. 16, 152 A.2d 35, 42 (1959); State ex rel.

Utility Commission v. General Tel. Company, 285 N.C. 671, 208 S.E.2d 681, 686-690 (1974); Petition of New England Tel. and Tel. Company, 115 Vt. 494, 66 A.2d 135, 147 (1949); Re: Middle States Utilities Company, 72 P.U.R. (N.S.) 17, 28-30 (Mo.P.S.C. 1947). See, Re: North Missouri Tel. Company, 49 P.U.R.3d 313, 317-9 (Mo.P.S.C. 1963); Re: Western Light & Tel. Company, 10 P.U.R.3d 70, 74-76 (Mo.P.S.C. 1955); Re: The United Tel. Company, 1 Mo.P.S.C. (N.S.) 341, 349-50 (1948); Public Service Commission v. Missouri Utilities Company, 1932E P.U.R. 449, 489 (Mo.P.S.C. 1932); Re: Lexington Water Company, 1928E P.U.R. 322, 345-6 (Mo.P.S.C. 1928). See generally, Note, "Public Utility Law -- Public Service Commission Ordered Rebates for Inadequate Service," 1976 Wisc. L. Rev. 584 (1976); See cases cited at Mo.P.S.C. Digest, Rates, sec. 25; Mo.P.S.C. Digest, Return, sec. 30; 4 P.U.R. Digest (Cumulative), Rates, sec. 150; 5 P.U.R. Digest (Cumulative), Return, sec. 36; 1 Priest, Principles of Public Utility Regulation: Theory & Application, 206-7 (1969); Nichols and Welch, Ruling Principles of Utility Regulation: Rate of Return, 382-95 (1955); Nichols and Welch, Ruling Principles of Utility Rate Regulation: Rate of Return (Supplement A), 303-7 (1964); Bonbright, Principles of Public Utility Regulation, 262-5 (1961); Note, "The Duty of a Public Utility To Render Adequate Service: Its Scope and Enforcement," 62 Colum. L. Rev. 312, 329-31 (1962); Note, "Public Utilities -- Fair Rates for Fair Service," 53 N.C. L. Rev. 1083 (1975); Nolan, "Incentive Rate of Return," Public Utilities Fortnightly, 50 (July 30, 1981); Article, "Service, Efficiency and Rate of Return", Public Utilities Fortnightly, 46 (January 18, 1979).

The Supreme Court of the United States left no doubt in its Bluefield decision that efficient and economic management must be considered in the context of setting the allowed return on a utility company's rate base:

> "The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economic management, to maintain and support its credit, and enable it to raise money necessary for the proper discharge of its public duties." (Emphasis added).

Bluefield Water Works & Improv. Company v. Public Service Commission, supra, 262 U.S. at 693. This language makes it clear that the Commission must consider evidence regarding the efficiency and economy of management in order to determine a proper return for the Company. Moreover, since Bluefield, "[n]umerous other decisions have recognized that superior service commands a higher rate of return as a reward for management efficiency and, conversely, that inefficiency and inferior service merits a lower return." (Emphasis added). Note, Wisc. L. Rev., supra at 594.

An excellent statement of the relevant principles has been noted by Nichols and Welch, quoting a Michigan Commission ruling:

> The commission believes it proper to base its rate of return in some degree upon the economy and efficiency with which the utility in question serves the public. The owners of a utility who are alert and active at all times in an endeavor to serve their public at the lowest possible reasonable cost are entitled to be compensated for their efforts. The amount of money going to the owners of a utility by way of return upon the fair value of the property used and useful in serving the public is ordinarily rather a small proportion of the total amount the patrons of the utility are required to pay. By far the greater amount the public is required to pay is used up in operating expenses, taxes, and the maintenance of the property. Where the owners of a utility make use of every reasonable economy that will keep the operating expenses at the lowest possible reasonable figure, they can and should be granted a greater rate of return than they should receive where these efforts are not made. Assume two gas utilities existing under practically the same conditions; one of them through up-to-date methods is able to furnish gas to the public at a given price, while it costs the other 10 cents per M cubic feet more than it costs the first one. Should the owners of each utility receive the same rate of return? The commission thinks not. Enterprise, economy, and efficiency should receive some reward. The only means by which the owners of a utility can be compensated for their enterprise, efficiency, and economy is through the rate of return. Eight per cent is proper in some cases; 7 per cent or 6 per cent or possibly less would be sufficient in others. The commission will not hesitate to fix a higher rate of return where circumstances warrant it and conversely a lower rate of return will be fixed where conditions seem to demand it and this rate of return should be changed from time to time to correspond with the performance of the utility." (Emphasis added).

Nichols and Welch, Ruling Principles of Utility Regulation: Rate of Return, 382-3 (1955).

This Commission, since its report and order issued in ER-82-39 and WR-82-50, supra, has included in its rate case suspension orders directives requiring the parties to present evidence on issues this Commission finds indispensable to its ratemaking duties. One of those issues is management efficiency. The Commission believes that company performance in providing the most efficient least-cost energy to customers is a company factor to be recognized in the ratemaking process. This Commission is committed to a ratemaking policy consistent with the cited authorities wherein superior service by a utility which saves customers money due to lower operating expenses should be recognized by an upward adjustment to a utility's rate of return, while inferior performance should result in a downward adjustment.

While Empire operates one of the smaller utilities in this state (71,352 Missouri residential customers) with an essentially suburban and rural service area of lower-than-average customer density and customer income, it has managed to achieve rates among the lowest in Missouri and the nation. Additionally, Empire by diligent management in the past seven years has increased its customers served per employee by over 4 percent. This was done while maintaining excellent customer relations, which is evidenced by Empire's leadership in customer oriented programs such as "Project Help" (aid to low income customers and the elderly) and Empire's low level of service complaints.

Empire has in the past shown cooperation in implementing recommendations of Staff audits on management efficiency and has voluntarily engaged in such audits itself. After the instant case was filed Empire took advantage of changing market conditions to negotiate a new coal contract to reduce its already reasonable coal prices. Further evidence of Empire's management efficiency is shown by its relatively low embedded cost of long term debt and embedded cost of preferred stock in light of the fact that during the years 1977 to 1981 Empire nearly doubled its capitalization.

Consequently, the Commission is of the opinion that an upward adjustment should be made to the Company's required rate of return on equity determined above. The Commission notes that other commissions around the country have made adjustments varying from .4 percent to 1.0 percent. See: Re: Detroit Edison, 47 P.U.R.4th 292 (Mich. P.S.C. 1982); Re: Southwestern Public Service Co., 27 P.U.R.4th 302 (N.M. P.S.C. 1978); Re: General Telephone Co. of California, 37 P.U.R.4th (Cal. P.U.C. 1980); Re: Narragansett Electric, 40 P.U.R.4th 498 (R.I. Util. Comm. 1980); Re: General Telephone Co. of the Southwest, 39 P.U.R.4th 483 (Texas P.U.C. 1980); Re: Carolina Power and Electric, 49 P.U.R.4th 188 (N.C. Util. Comm. 1982); Re: Blountsville Telephone Company, 49 P.U.R.4th 102 (Ala. P.S.C. 1982). Because of this relatively new ratemaking approach in Missouri, the Commission finds .4 percent to be appropriate in this case, and invites parties in the future to suggest specific adjustments wherever warranted. Therefore, .4 percent will be added to the required return on equity as determined above to reach a total allowed return on equity in this case of 15.03 percent.

For future cases, the evidence submitted in this case will not suffice. That is, this Commission expects a continuing and ongoing effort on the part of the Company to ever improve its cost and quality of service. New methods and thresholds of superior performance must be introduced and achieved if Empire is to receive an adjustment in future rate cases.

The Commission is of the opinion that recognition of Company performance through a rate of return adjustment is necessary to encourage the provision of energy on the most efficient and economical basis possible. However, the success of such a policy depends upon the investigation and presentation of information and evidence by the parties involved in rate cases such as this. Consequently, such information should be provided by all parties in future cases in order to consider a rate of return adjustment.

Revenue Requirement

The rate of return found herein to be reasonable and proper results in a total net operating income requirement for Missouri operations in the amount of $15,467,556. After applying the proper allowance for income tax and the increase for projected fuel prices, the gross revenue deficiency is found to be $1,653,998.

Fair Value Rate Base

Since the parties presented no evidence on this issue, the Commission must use the Company's net original cost rate base in determining this Company's fair value rate base. The Commission finds the Missouri jurisdictional portion of the Company's fair value rate base to be $151,963,087 for electric operations. This amount includes all necessary components of rate base required by law. Applying the net operating income requirement of $16,336,032 for electric operations which has been found reasonable in this case to the electric fair value rate base produces a fair value rate thereon of 10.75 percent, which the Commission finds to be fair and reasonable.

Rate Design

At the time of the hearing the Company, Staff and Industrial Intervenors supported Staff's proposed split fuel method of spreading the increased revenue requirement that was over and above that stipulated to in the Company's last rate design case, Case No. EO-82-40. The Office of Public Counsel proposes the increased revenue requirement be spread on an equal percentage basis.

Before discussing the merits of the parties' positions, the Company's motion to strike the testimony of witness Andersen must be ruled on. Public Counsel sponsored witness Andersen as a rebuttal witness to Staff's position regarding its split fuel method. The Company maintains that since Public Counsel did not file direct testimony proposing the equal percentage method witness Andersen supported, Public Counsel should be precluded from presenting what Company maintains is direct testimony in Public Counsel's rebuttal testimony. The Company, supported by the

Industrial Intervenors, believes that for a party to argue a position on rate design, it must first prefile its position on rate design as direct testimony.

The Commission in this instance must reject the Company's arguments. As Public Counsel points out, the Company in its proposed tariffs and direct testimony used an equal percentage method to spread the revenue increase the Company filed for in excess of that allocated for in the stipulation and agreement in EO-82-40. No mention of a split fuel method was made. Consequently, Public Counsel, by the Commission's suspension order and notice of proceedings, was not required to present a rate design method, since it did not intend to propose something different than that filed by the Company. Public Counsel was also thereby free to present rebuttal testimony at the hearing to rebut the Staff's split fuel method proposal in favor of the Company's original filing. The change in the Company's rate design methodology does not preclude Public Counsel from asserting the equal percentage method.

Public Counsel's equal percentage method would spread the revenue increase in question by an equal percentage among the rate classes. Staff's split fuel method singles out the increase or, in this instance, decrease in fuel costs and distributes such on a per kilowatt hour basis, with the shift in nonfuel related costs, in this instance an increase in the Company's revenue requirement, on an equal percentage basis between the rate classes.

The Staff points out, and Public Counsel agrees, that changes in fuel costs are readily identifiable. The record shows that Empire's fuel costs have declined on a per kilowatt hour basis. This is the result of a decrease in the cost of Empire's per unit cost of coal since its previous rate case. Since energy costs are directly related to the amount of energy consumed by each customer and this relationship is readily identifiable even when no cost of service study has been performed, the Staff asserts that it is appropriate to recognize said relationship through the split fuel method of spreading revenues in this case. The Company, in support of Staff, points out that no new generation capacity has been added since the Company's last rate case, and that the increase in nonfuel costs have resulted from, and correspond essentially to, the general inflationary trend and normal growth of the system.

Public Counsel argues that the split fuel method will not maintain the class rate structure stipulated to in EO-82-40, and its argument is as follows. Class rate structures are developed by identifying and allocating energy and nonenergy costs. Energy related costs involve more than fuel costs. Pursuant to the Commission's directions in previous cases, certain fixed costs are allocated on an energy basis pursuant to the average and peak and time of use allocation methods. Public Counsel maintains that while fuel costs represent one-third of the Company's revenue requirement, nonfuel energy related costs represent an equal amount and should not be ignored. Consequently, to identify only fuel costs and allocate them on a per kilowatt hour basis would ignore the possibility that nonfuel energy related costs are rising, and consequently Staff's method would result in a reduction among the rate classes of kilowatt hour charges when such charges on an energy basis are actually going up. Therefore, in the absence of evidence to the contrary, it is improper to assume nonfuel energy related costs are going up in a more or less consistent fashion.

However, if such costs are rising in a uniform manner along general inflationary trends, then the split fuel method should preserve the rate class structures developed in ER-82-40, supra. Consequently, what is really at issue here is whether the Company's nonfuel energy related costs are rising in a consistent and uniform manner. The only evidence on this matter comes from Company witness Fancher, who stated that such costs were rising in a uniform and consistent manner. Public Counsel provides no evidence or argument to refute such beyond claiming witness Fancher's statements are unsubstantiated. It seems that such an issue should be easily tested. If costs, whatever they be, are rising or dropping at a rate greater than the average such that they would make the impact asserted by Public Counsel, they should be readily identifiable. In fact, such appears to be the only case in the area of fuel.

Based on the foregoing, the Commission finds that the split fuel method should be used for purposes of this case.

Miscellaneous

Late Payment Charge

The Company proposed a late payment charge of 1.5 percent on the balances of outstanding bills of residential customers. The Staff did not oppose the Company on this issue and agreed that there should be a late payment charge. The Office of Public Counsel, while not categorically opposing the imposition of a late payment charge, argued that the charge should be 1.0 percent.

The Company based its 1.5 percent proposal on Schedule RBF-2 in witness Fancher's testimony in Exhibit 2. That schedule computes the Company's cost of money on an overall basis from bonds to common stock. Public Counsel, rather than criticize the Company's computation, noted from other witnesses' testimony that the prime interest rate had fallen to 10.5 percent, that average utility bonds were down to 13.55 percent in December of 1982, and that the Company's cost of commercial paper was 8.925 percent.

Since the Company's cost of money testimony offered on this issue was not challenged and it appears from the record that there are other costs inherent in late payment, the Commission finds that 1.5 percent is proper and reasonable.

Disconnect/Reconnect Charges

Empire proposes to increase its disconnect/reconnect charges by the following amounts:

Charge for sending Empire employee to premises	from \$5.00 to \$8.00
Reconnection fee:	
- During normal working hours	from \$10.00 to \$18.00
- After normal working hours	from \$16.00 to \$33.00

The Staff recommends that these proposed disconnect/reconnect charges be approved as filed.

Having reviewed the above proposed charges and the recommendations of its Staff, the Commission finds that the disconnect/reconnect charges should be approved as filed.

PURPA

On February 3, 1983, the Commission issued an order in this matter requiring the Company, Staff and any other interested party to file evidence concerning the adoption or rejection of the load management techniques standard as found in Section 111(d) of the Public Utility Regulatory Policies Act of 1978, P.L. 95-617, 16 U.S.C., Section 2601 et seq. Company, Staff and Public Counsel all recommend adoption of the standard, which reads as follows:

> (6) Load management techniques. -- Each electric utility shall offer to its electric consumers such load management techniques as the State regulatory authority (or the nonregulated electric utility) has determined will --
> (A) be practicable and cost-effective, as determined under section 115(c),
> (B) be reliable, and
> (C) provide useful energy or capacity management advantages to the electric utility.

In light of the parties' unanimous support of this standard and the goals it is fashioned to achieve under PURPA, the Commission finds that said standard should be adopted by this Commission for this Company. In doing so, the Commission, by this Report and Order, is directing the Company to immediately begin the data collection necessary for the development and application of load management techniques pursuant to the standard herein adopted. In the Company's next rate case the Company shall file an implementation plan for those load management techniques developed from analysis and evaluation of the data collected pursuant to the above directive. Furthermore, the Company is directed to apprise the Staff of its actions on a periodic basis informing the Staff of the Company's data collection methods, Company's identified load management techniques, Company's analysis and evaluation of said identified techniques and Company's implementation plans of chosen techniques, and other relevant information. At any point the Staff believes the Company is not properly implementing these directives, it shall immediately petition the Commission for resolution thereof.

Rate Implementation

On June 13, 1983, the Company by letter informed the Commission of the unique difficulties inherent in implementing a rate increase and a rate design change at the same time. Since the rate increase herein approved is for service rendered on and after the effective date of this Report and Order, customer bills for service rendered before and after the effective date of this Report and Order will need to be prorated by the Company. However, due to the added difficulties created by the implementation of the stipulated rate design from Case No. EO-82-40, the Company requested that it be allowed to apply the rate changes resulting from the stipulated rate design to bills rendered on and after the effective date of this Report and Order.

The Staff informed the Commission that it had no objection to the Company's request. However, the Office of Public Counsel objected to the Company's request on the grounds that such would result in retroactive ratemaking.

Since it appears that Public Counsel's position is technically correct, the Commission must deny the Company's request. The Commission finds that the Company shall implement the rate design in its next billing cycle that begins charges for service rendered entirely on and after the effective date of this Report and Order.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law:

The Company is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, R.S.Mo. 1978. The Company's tariff sheets which are the subject matter of this proceeding were suspended pursuant to the authority vested in this Commission by Section 393.150, R.S.Mo. 1978.

The burden of proof to show that the proposed increased rates are just and reasonable is upon the Company.

Orders of this Commission must be based upon competent and substantial evidence upon the whole record.

The Commission, after notice and hearing, may order a change in the rate, charge or rental, in any regulation or practice affecting the rate, charge or rental, and it may determine and prescribe the lawful rate, charge or rental and the lawful regulation or practice affecting said rate, charge or rental thereafter to be observed.

The Commission may consider all facts which, in its judgment, have any bearing upon a proper determination of the price to be charged with due regard, among other things, to a reasonable average return upon the capital actually expended, and to the necessity of making reservations out of income for surplus and contingencies.

Any evidence received without objection which has probative value shall be considered along with other evidence in the case. Evidence which is not of such quantity to be persuasive of the fact to be established may be rejected even if not objected to or controverted.

When the Company's existing rates and charges are insufficient to yield reasonable compensation for electric service rendered by it in this state and, accordingly, revisions in the Company's applicable tariff changes, as herein authorized, are proper and appropriate and will yield the Company a fair return on the net original cost rate base or the fair value rate base found proper herein, new rates resulting from the authorized revisions that will be fair, just, reasonable and sufficient and not unduly discriminatory or unduly preferential should be authorized.

Although there is no requirement that a test year, or any other specific procedure, be used, a test year is commonly utilized in an attempt to measure a period of normal operations, to which reasonable adjustments may be made to permit the establishment of a reasonable estimate of conditions during the period of time in which the new rates will be in effect.

Under ordinary circumstances, adjustments to a test year are confined to those permitting a matching of revenues and expenses. When known increases in expenses will occur, the inequity in disallowances for a lack of precise measurement may outweigh the potential for unfairness in the allowance of the expense for which the precise corresponding revenues cannot be established.

For ratemaking purposes, the Commission may accept a stipulated settlement on any contested matter submitted by the parties. The Commission finds that the matters of agreement between the parties in this case should be accepted for purposes of this case.

No individual allowance is improper if it has not contributed to an ultimate rate level that is in excess of that which is fair and reasonable.

Any motion not previously ruled on should be considered denied, and any objection not previously ruled on should be considered overruled.

It is, therefore,

ORDERED: 1. That the proposed revised electric tariffs filed by The Empire District Electric Company in Case No. ER-83-42 are hereby disapproved, and the Company is authorized to file in lieu thereof, for approval by this Commission, permanent tariffs designed to increase gross revenues by approximately $1,653,998 on an annual basis, exclusive of gross receipts and franchise taxes.

ORDERED: 2. That Case No. EO-83-364 be, and hereby is, established pursuant to the stipulation and agreement on forecasted fuel costs approved herein, to be styled "Investigation and audit of forecasted fuel expense of The Empire District Electric Company"; and that the entire record of Case No. ER-83-42 shall be incorporated by reference as evidence in said Case No. EO-83-364.

ORDERED: 3. That The Empire District Electric Company shall file the tariffs in compliance with this Report and Order on or before June 22, 1983.

ORDERED: 4. That the rates to be established in the tariffs may be effective for service rendered on and after June 27, 1983.

ORDERED: 5. That the stipulated rate design to be implemented pursuant to the stipulation and agreement in Case No. EO-82-40 be applied to the Company's next billing cycle wherein the rates charged are for services rendered entirely on and after June 27, 1983.

ORDERED: 6. That this Report and Order shall become effective on the 27th day of June, 1983.

BY THE COMMISSION

Harvey G. Hubbs

Harvey G. Hubbs
Secretary

(S E A L)

Shapleigh, Chm., Fraas, Dority and Musgrave, Concur and certify compliance with the provisions of Section 536.080, R.S.Mo. 1978.

Dated at Jefferson City, Missouri, on this 17th day of June, 1983.